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Introduction to the Banking Law Symposium: A 200 Year Journey from Anarchy to Oligarchy

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Each of the five articles in this symposium deals in one way or another with a single question: In what ways and to what end should banks be regulated? Although banks and bankers are the very symbols of a capitalist economy, banks and bankers are not free. No banker may set up business on his own; he must have a charter. With insignificant exceptions no bank or bank holding company can operate a steel mill, sell grass seed, manufacture snowmobiles, or engage in any other activity that is not related to banking. There are rules that limit the geographic scope of a bank's activity, the places it may open an office, and even the amounts it may lend and the prices it may charge. Each of the five articles in this symposium examines a different legal problem and discusses a form of bank regulation. In some cases the regulation is found in federal statutes or administrative rules. In other cases it is found in court decisions or in state laws.

Professors Garten and Macintosh are liberal apologists for the maintenance, and perhaps even for the extension, of the regulation of banking activities. Professor Garten has a tall order, for she defends the current bank regulation and insurance system that presided over a savings and loan crisis that will cost more in nominal dollars than were spent waging World War II. She admirably meets that challenge. Professor Macintosh advocates the expansion of judicial supervision over certain banking activities where the bank might be regarded as a knowing accomplice of improper debtor behavior.

Professor Malloy is less an advocate and more an objective reporter. He reports on Congress' recent revision of federal bank regulation and insurance law (known as FIRREA¹), reviewing with neither malice nor glee the various provisions of the Act—much as a disinterested reporter at the scaffold during the French Revolution might coolly enumerate the Revolution's victims. These provisions grant many additional powers and much new authority to federal regulators.

Less a journalist than Professor Malloy and less an advocate than Professors Garten and Macintosh, Professor Park anguishes over the tension that he sees in international banking between Third World nations and the banks of the industrialized nations. Professor Park reveals the plight of banks caught in the political crossfire

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1. Financial Institutions Reform, Recovery and Enforcement Act, Pub. L. No. 101-73, 103 Stat. 183 (codified at various sections of 12 U.S.C.A. (West Supp. 1989)).

between countries such as the United States on the one hand and Iran or Libya on the other.

The fifth piece by Kenneth Warren deals with a bank's power to recover attorneys' fees from defaulting debtors. It traces the history of a judge-made rule against a bank's collection of attorneys' fees that arose in an 1840 Ohio case. Although occupying the opposite end of the spectrum from Professor Garten's grand discussion of the overall effects of the regulatory system, specific issues such as charging lawyers' fees are nevertheless of great concern to banks. The thousands of little limitations upon banks' powers that are inflicted by the courts in the name of equity may be more important collectively than more obvious and ambitious regulatory rules thought up in Congress or the state legislatures.

Because it is unthinkable even to the most aggressive libertarian that banks could and should be free to do as they please, almost everyone in this debate must return again and again to the questions: How and how much should banks be regulated? To what extent should the regulators' power be limited? To what extent should the regulatory power be divided so that the power of the particular regulators is weakened? To what extent should banks be foreclosed from certain lines of work and certain commercial and industrial alliances to minimize their power? The legislation and the cases discussed below deal in one way or another with these questions. They are important questions, for the courts and the Congress will certainly return to them. The cases decided by the courts and the legislation produced by the Congress will be wiser and better informed to the extent that the ideas in this symposium add to the debate.

Each of the five papers devotes appropriate and careful attention to a different problem of interest to lawyers. I want to put the events that lie behind these papers into an historical perspective and to speculate about their meaning, not so much for lawyers as for laymen. I believe that the various events of the 1980s—the crises, foreign and domestic, and the legislation and other regulatory and economic responses to those crises—have accelerated an irreversible decline in the state banking system. I believe that these events will lead to the homogenization of financial institutions and ultimately to the consolidation of most of our financial institutions into a small number of national banking institutions.

1. *Regulatory History*

One can start this bank regulatory history with two cases in the early nineteenth century. Despite the United States Supreme Court decision in *McCulloch v. Maryland*² that the National Bank was immune from state taxation, the State of Ohio continued to levy taxes upon National Bank branches located in Ohio. Five years after *McCulloch v. Maryland*, Ohio too was told it could not collect such taxes in *Osborn v. Bank of the United States*.³

This hostility to the National Bank found in state taxing authorities shortly had

2. 17 U.S. (4 Wheat.) 316 (1819).

3. 22 U.S. (9 Wheat.) 738 (1824).

its counterpart in Washington. When Andrew Jackson was elected to the Presidency in 1832, he was joined by many state bankers, antibank agrarians, states-rights politicians, and others in his antipathy to the Second National Bank. In July 1832, he vetoed the Congressional renewal of the Second National Bank's first charter. In a veto message containing explicit criticism of "foreigners" as the owners of some of the stock of the Second National Bank and a scolding for the "rich and powerful" who "too often bend the acts of government to their selfish purposes," President Jackson denounced the National Bank. Before its original charter expired in 1836, he had reduced the Bank to a shell by removing all government deposits from the Bank and redepositing them in state banks.

It was not until the National Currency Act of 1863⁴ and its amendments in the National Bank Act of 1864⁵ that the nation saw the kind of nationally chartered commercial banks that are now common. Only in December of 1913 with the passage of the Federal Reserve Act⁶ did the federal Congress and executive branch muster the courage to establish a true central bank.

The next substantial amendment to bank regulation came with the Great Depression. With the Glass-Steagall Act (the Banking Act of 1933)⁷ and the Banking Act of 1935,⁸ Congress did a number of things to limit the power of banks and to extend the power of federal regulators over state as well as federal banks. Among other things, these acts substantially divided the commercial banking function from the investment banking function. They established the Federal Deposit Insurance Corporation (FDIC),⁹ an agency that ultimately gained substantial power over many state banks that were not otherwise subject to the Federal Reserve or to the Comptroller's regulation.

Thus, the acts of the Depression moved in two directions. On the one hand, they diminished the power of the large banks by restricting them to commercial banking and by barring them from most investment banking activities as well as most other activities unrelated to banking. On the other hand, they increased the power of the federal regulators over state banks by establishing the FDIC and by extending the powers of the Federal Reserve.

Even while the Congress was cautiously expanding the powers of the federal regulators and of national banks, it was sensitive and deferential to the interests of the states. For example, to this day the power of a national bank to branch within a particular state is largely determined by what state banks in that state can do. The

4. National Currency Act of 1863, 37th Cong., 3d Sess., ch. 58, 12 Stat. 665 (codified as amended at various sections of 12 U.S.C.A. (West Supp. 1989)).

5. National Bank Act of 1864, 38th Cong., 1st Sess., ch. 106, 13 Stat. 99 (currently codified as subsequently amended primarily at 12 U.S.C.A. §§ 1-39 (West Supp. 1989)).

6. Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251 (1913) (codified as subsequently amended primarily at 12 U.S.C.A. §§ 262-522 (West Supp. 1989)).

7. Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (codified as amended at various sections of 12 U.S.C.A. (West Supp. 1989)).

8. Banking Act of 1935, Pub. L. No. 74-305, 49 Stat. 684 (codified as amended at various sections of 12 U.S.C.A. (West Supp. 1989)).

9. Banking Act of 1933, § 8, amending Federal Reserve Act to create FDIC (currently codified as amended at 12 U.S.C.A. ch. 16 (West Supp. 1989)).

power of a bank holding company to enter a state is limited by the wishes of that state's legislature.

Within the federal and state governments the regulation of financial institutions has been divided according to type of institution. Commercial banks, savings and loan organizations, and even credit unions and savings banks have had separate regulators. In most cases each of these various financial institutions has had special powers.

Because of this recognition of the states' interest and because of local bank opposition, there was little cross-state retail banking until 1980. Until then, the only banks with retail branches in more than one state tended to be grandfathered anomalies such as the Bank of California. Banks could enter other states only by subterfuge, as by the establishment of "loan production offices" that theoretically were merely sales offices whose power of granting or withholding credit was lodged back at the home office in another state. Because most operations of most banks were limited to a single state, it was sometimes convenient for a banking institution which thought itself ill treated by the Comptroller on the one hand, or by the state banking authorities on the other, to change its charter from federal to state or vice versa. By whipsawing the regulator, the bank could maximize its power and could limit the authority of a particular regulator by the threat of moving into the competing regulator's jurisdiction.

Because of the diversity of regulation within a geographical area by type of institution, it was sometimes possible for one financial institution to devise and implement a product that competing banks and other regulators wished to keep out of the market. That was the case with NOW accounts in Massachusetts in the 1960s. Many banks and federal regulators would have preferred the status quo, which prohibited the payment of interest on checking accounts. When the Massachusetts savings banks successfully introduced NOW accounts—nominally savings accounts, but in fact interest-bearing checking accounts—and the competition began to make inroads on competing commercial banks, federal and other state regulators had to allow similar accounts to commercial banks. They were never able to suppress the interest-bearing checking account, which ultimately spread from coast to coast and is now available in one way or another at virtually every banking institution.

Although it is often claimed that this division of regulatory power has contributed to the savings and loan crisis and the decline and fall of a number of the banks in the Southwest, that claim is by no means proved. On the contrary, I believe that this division of regulatory power has inhibited the kind of oligarchical, cozy relationship that has developed in other regulated industries between the regulators and the powerful members of the regulated industry. Because of competition among the regulators within one system and between the states and the federal government, it was not possible for such a cozy relationship to develop everywhere.

2. The Accelerated Decline of State Regulatory Power

In my view, the events of the 1980s that are discussed in one way or another in the articles in this symposium are steps in the irregular but continuous decline of the

state banking system from its apogee before the Civil War. I predict that the turn of the century will see a state system weaker and smaller in every way than it is today. That day will see more powerful federal regulators and larger and more powerful national banks. I predict that the banking industry will look much more like a traditional regulated industry characterized by a symbiotic relationship between the banks and the regulators, and by a genteel form of competition among its members, all stimulated and maintained in a more or less conscious way by the regulators themselves.

To understand my hypothesis, consider first the consequences of the various debt crises of the 1980s. A banking crisis limited mostly to savings and loans in 1985 brought Chase Manhattan to Ohio. Later and similar difficulties, both in the banking and in the savings and loan industries in Oklahoma and Texas, made Chemical Bank and North Carolina National Bank (NCNB) two of the largest banks in Texas. Every time there is a substantial threat of disruptive bank failure in a particular state, federal authorities and aggressive out-of-state banks use that crisis as an opportunity to cross state lines. Once they have done that, it is difficult to keep others from crossing into the state and, inevitably, any such state has in effect been subjected to interstate banking despite the fact that the local legislature never willingly authorized entrance by out-of-state banks.

The state barriers have also fallen as a result of conscious and intentional decisions of the state legislatures. We now see Bank One of Columbus, Ohio, with retail banking subsidiaries in Michigan, Indiana, Wisconsin, and several other states. Citicorp and even the Ford Motor Company have financial subsidiaries in many states. Clearly that trend of the 1980s is gaining momentum as we enter the 1990s.

The "savings and loan crisis" of 1988 produced FIRREA.¹⁰ FIRREA will speed the decline of the state banking industry by direct and indirect means. First, it makes possible the acquisition of even healthy savings and loans by commercial banks¹¹ and foretells their ultimate assimilation into commercial banks. So, too, this crisis has seen the FDIC absorb the savings and loan insurance fund and has witnessed the replacement of the Federal Home Loan Bank Board with a Director of the Office of Thrift Supervision under the Secretary of the Treasury.¹² This homogenization of banking powers will cause more financial institutions to be governed by fewer regulators and will accordingly increase the powers of those regulators.

More directly, FIRREA increases the specific supervisory powers of the federal regulators.¹³ As Professor Malloy points out, it grants regulators cease and desist powers¹⁴ where they had none before and grants various other powers, large and small, to influence unwilling financial institutions.

The international debt crises of the 1980s, in which large and medium-sized

10. Financial Institutions, Reform, Recovery and Enforcement Act, Pub. L. No. 101-73, 103 Stat. 183 (codified at various sections of 12 U.S.C.A. (West Supp. 1989)).

11. *Id.* tit. VI.

12. *Id.* §§ 401, 703.

13. *Id.* tit. IX.

14. See Malloy, *Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation*, 50 OHIO ST. L.J. 1117 (1989).

American banks faced financial difficulties because the Mexicans, the Brazilians, and borrowers in other Third World countries defaulted on their debts, may also lead to consolidation and increases in size. It is sometimes argued that our banks do not compete effectively with the Japanese in this international market because even our large banks are too small. If only they were larger, they might somehow learn to lend to the Brazilians and make money doing it. (Alternatively, it may be a sufficient justification for allowing larger banks that they could better withstand the inevitable losses that arise out of such foreign lending.) In any event the global nature of the market dictates that there are some costs that even large American banks cannot bear, and thus loans in that market that they cannot make.

In many ways, some subtle and some obvious, these events weaken the state regulators and the state banking systems, and strengthen the national regulators and the national banks. Consider some of them. Once a bank has a truly multistate system, it will no longer be feasible for it to threaten to become a "state bank" in order to escape federal regulation. To do that it would be necessary for the bank to adopt state charters not in one state, where there is a friendly banking commissioner, but in several. Because the corporate form of any such bank will necessarily be a bank holding company, its parent corporation will remain subject to federal supervision even if its subsidiaries converted. A threat to adopt a state charter will ring hollow.

By the same token the deviant demands of a state regulator that a multistate bank do something in his state even though that thing is not commonly done elsewhere will be easier to disregard. The state regulator will not be dealing with a single state bank over which he has control, but with a multistate banking organization operating in concert with the federal regulators. These federal regulators are likely to be supportive of a multistate bank's need for uniformity, and they may be happy to see state regulatory powers diminished. In those circumstances it is likely that the multistate banking system will be successful in persuading federal regulators—and perhaps in some cases even the Congress—to protect it against deviant state demands.

But the state banking authorities' problems will not end there. With the crises of the 1990s and beyond, companies like Citicorp and Ford Motor Credit, overseeing large numbers of diverse financial institutions in many states, will argue they should not be denied the economies of scale that would come from consolidating all of these organizations under one corporate roof with one set of rules applicable to all. When that happens, even local rules on usury and certainly those on local branching and investment will be in jeopardy. By 2020 one can imagine the possibility of a national bank establishing a branch in a state without any regard to the state banking commissioner or the state laws concerning branching, and with no more difficulty than Sears, Roebuck might have in establishing a store at the local shopping mall.

When that day arrives, the state banking commissioner will be presiding over a banking backwater of modest size. The economies of scale in being a national or even an international bank are beyond my ken. However, observation of the concentration in the Japanese, Canadian, and European banking markets suggests that there are economies in large size. If the interstate limitations alone have kept American banks from growing to the size that will maximize efficiency, one would expect that a

complete abolition of interstate barriers would cause the large banks not only to enter every state, but also to consolidate financial resources by buying banks in the states where they are already doing business. Assuming that our antitrust laws allow such consolidation, one might guess that the abolition of all interstate limitations would cause ten or twelve banks to be represented in virtually every banking market in the United States and to account for a large percentage of all deposits. Observation not only of the banking industries elsewhere but of comparable unregulated industries here (such as the brokerage business) suggests that we may well witness such a consolidation.

Even if the consolidation is not as extensive as I have suggested, it is clear that the complete fall of interstate limitations will bring substantial consolidation, for most out-of-state banks will enter new markets not through *de novo* banking, but through mergers and acquisitions. If there are great efficiencies, their presence will drive less efficient smaller banks into the arms of competitors and so increase the consolidation.

3. *Andrew Jackson's Ghost*

Only then—perhaps in 2032, the 200th anniversary of Andrew Jackson's veto—will we stand at the far end of the journey begun shortly after 1832. That journey takes one from a state banking system, authorized and regulated exclusively by the states and characterized by modestly sized institutions and fragmented regulation, to a system that is exclusively national, highly concentrated and governed by one, or at most two, federal regulatory bodies. Then we will know whether Jackson's fear of concentration of power and his instinctive populist hostility to "monied interests" was justified. Many other industrialized countries, such as Japan and West Germany, have prospered under a highly concentrated banking industry, and we may have exaggerated the benefits and underestimated the cost of having a fragmented system.

Will the children of the twenty-first century dance on Andrew Jackson's grave? Or will his ghost laugh as our descendants suffer the curse of a highly regulated but inefficient oligopolistic system? We can only guess. But at least we should recognize this decade's events as important milestones on the journey to a much different banking system than we have known.

